United States Court of Appeals

for the Second Circuit

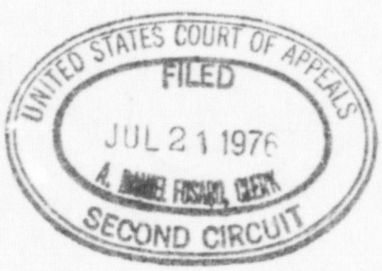
APPELLEE'S PETITION FOR REHEARING EN BANC

75-7608

In the

United States Court of Appeals

For the Second Circuit



Irving Sanders,

Plaintiff-Appellee,

—against—

Leon Levy, *et al.*,

Defendants-Appellants.

Egon Taussig,

Plaintiff-Appellee,

—against—

Sidney M. Robbins, *et al.*,

Defendants-Appellants.

Michael Shaev and Rita Shaev,

Plaintiffs-Appellees,

—against—

Eric Hauser, *et al.*,

Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

PETITION FOR REHEARING AND SUGGESTION FOR REHEARING *IN BANC* BY PLAINTIFFS-APPELLEES

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PETITION FOR REHEARING AND SUGGESTION FOR REHEARING IN BANC BY PLAINTIFFS-APPELLEES

Plaintiffs-appellees, pursuant to Rule 40 of the Federal Rules of Appellate Procedure, petition for rehearing of the decision of this Court dated June 30, 1976, insofar as it reversed the order of the district court directing defendant Oppenheimer Fund, Inc. (the "Fund") to cull out the names and addresses of the class members from the Fund's computer tapes at the Fund's expense. Plaintiffs-appellees further respectfully suggest to the Court that this case is an appropriate one for rehearing in banc pursuant to Rule 35 of the Federal Rules of Appellate Procedure.

REASONS FOR GRANTING THE PETITION AND BASIS FOR SUGGESTION FOR REHEARING IN BANC

In reversing, by a two-to-one majority, the district court's order directing the Fund to cull out the names of the class members from the Fund's computer tapes at the Fund's expense, the Court has overlooked and misapprehended important points of fact and law. The majority opinion has, we submit, misconstrued the decisions by the Supreme Court in Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974) ("Eisen IV"), and by this Court in Eisen v. Carlisle & Jacquelin, 479 F.2d 1005 (2d Cir. 1973) ("Eisen III"). As Judge Hays states in his dissenting opinion:

> "The majority's decision, ostensibly predicated on the Supreme Court's decision in Eisen v. Carlisle & Jacquelin (Eisen IV), 417 U.S. 156 (1974), uncritically treats a discovery issue as notice and indiscriminately applies a rule appropriate to arm's-length relationships to the fiduciary relationship between the parties herein." (Slip Opinion, p. 4591.)

While apparently recognizing that, under the principles set forth in Eisen III and Eisen IV, there may be exceptions to the "usual rule" that the plaintiff must bear the costs of notice, the majority has construed these exceptions so restrictively as to make them essentially meaningless. The majority has, thus, transformed the usual rule into a much more pervasive and inflexible rule than was intended by either Eisen III or Eisen IV. It has made the usual rule applicable not only to notice costs but also to discovery expenses, and has extended the usual rule to cover situations where a fiduciary duty pre-existed between the plaintiff and the defendant.

The majority opinion also misapprehends, in certain important respects, the proper role of the district court in connection with the matters involved in this case. The majority has formulated strict rules covering matters that should rest within the sound discretion of the district court. The proper exercise of discretion by the district courts, particularly in cases, like the instant one, involving unusual facts and circumstances and fiduciary relationships between the parties, is essential, we submit, to insure the effective use of the class action procedure and to achieve fair and equitable results.

The decision by the majority involves questions of exceptional importance relating to the maintenance of class actions under Rule 23, including the proper role of the district courts in dealing with significant matters relating thereto. The majority decision, as Judge Hays notes, will "close yet another door to the class action procedure" and will undercut its effectiveness in

cases involving the breach of fiduciary duties. It will make it more likely that those who owe fiduciary duties to the class and who should, therefore, be held to a higher standard of accountability will be able to avoid liability for their wrongdoing to the class.

We respectfully submit that, for the reasons stated herein, the petition for rehearing should be granted and the decision of the district court should be affirmed. We further submit that, because of the serious implications of the majority decision with respect to the maintenance of class actions and the inconsistency between the majority's decision and the decisions by this Court and the Supreme Court in Eisen III and Eisen IV, respectively, it is appropriate that this matter be considered by the full Court and that a rehearing in banc be granted.

POINT I

THE MAJORITY, IN REQUIRING THE APPLICATION OF THE "USUAL RULE" THAT PLAINTIFF MUST PAY THE COSTS OF NOTICE TO THE INSTANT CASE, HAS MISCONSTRUED THE DECISIONS IN EISEN III AND IN EISEN IV.

A.

The District Court May Properly Impose Notice Costs upon a Defendant Where a Fiduciary Duty Pre-existed between the Plaintiff and the Defendant, as in the Instant Case.

Both this Court in Eisen III (479 F.2d at 1009, n. 5) and the Supreme Court in Eisen IV (417 U.S. at 178) noted that the usual rule that the plaintiff must bear the cost of notice may not apply "where a fiduciary duty pre-existed between the plaintiff and the defendant * * * ." Eisen IV, supra, at 178. The majority,

while recognizing this possible exception to the usual rule, has construed this exception too narrowly and has based its determination that this exception should not apply in the instant case upon certain erroneous factual assumptions. The majority appears to limit the exception to situations where the defendant is essentially in the position of a corporation in a shareholder's derivative suit or is a public service monopoly (Slip Opinion, pp. 4582-4583.) In Eisen IV, however, the Supreme Court cited Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968), as an example of a case that might present such an exception to the usual rule. See Eisen IV, supra at 178, footnote 15. In Dolgow, the defendant was neither a public service monopoly nor in the position of a corporation in a derivative suit. Indeed, in Dolgow, which, like the instant case, was a class action brought by plaintiffs on behalf of purchasers of securities, the defendants were in essentially the same position as the defendants in the instant case. In the portion of the opinion in Dolgow, specifically cited by the Supreme Court in Eisen IV, the Court indicated that a defendant corporation may be required to bear the cost of notice based upon the "[F]iduciary duty owed to purchasers of stock by the corporation...." Dolgow, supra, at 498.

There can be no doubt that there was a fiduciary relationship between the plaintiffs and the defendants in the instant case (Slip Opinion, p. 4596; dissenting opinion). Even the majority appears to recognize that the defendants had fiduciary duties to the plaintiffs and the class (Slip Opinion, pp. 4583-4584.)

The majority, nevertheless, disregards the fiduciary relationship between the parties herein and compels the application of the usual rule to the instant case, based upon two grounds, both of which,we submit, are unfounded. First, the majority asserts that many of the considerations pointed to in justification for shifting the costs of notice from the plaintiff to the defendant in Dolgow and in Eisen v. Carlisle & Jacquelin, 52 F.R.D. 253, 264-270 (S.D.N.Y. 1971), such as the strength of plaintiff's case and the ability of the defendant to bear the costs, have been shown to be inappropriate (Slip Opinion, p. 4584). It does not follow, however, simply because these considerations have been determined to be inappropriate, that other considerations such as the existence of a fiduciary relationship between the plaintiffs and the defendants, which both Eisen III and Eisen IV have indicated may justify the imposition of notice costs upon the defendants, should be disregarded. The inevitable result of the approach taken by the majority is the creation of a hard-and-fast rule that the plaintiff in a class action must pay the cost of notice, irrespective of legitimate considerations, like those in the instant case, which, this Court and the Supreme Court have indicated, may properly influence the court in determining who should bear the costs of notice.

The majority also bases its decision that the fiduciary relationship exception should be disregarded and the usual rule should apply in the instant case upon the mistaken assumption that the Fund is not a party to the class action claims and has no direct interest in the outcome of said claims and, thus, is too remotely

involved to have notification costs imposed upon it (Slip Opinion, pp. 4583-4584). The majority, however, has overlooked the fact that the defendants other than the Fund have asserted cross claims against the Fund in their amended answers, alleging that, if they are liable to the class by reason of the overvaluation of restricted securities in the portfolio of the Fund, then the Fund is liable to them to the extent that the Fund has received funds from the class by reason of such overvaluation (A-57, A-81).* Thus, contrary to the assumption by the majority, the Fund does have a direct interest in the outcome of the class action claims.**

The reasons for not applying the usual rule in cases like the instant one, where a fiduciary relationship exists between the defendants and the plaintiffs, have been cogently set forth by Judge Hays, as follows:

> "When the defendants assumed their positions with the Fund they knew, or clearly should have known, that the law imposes very strict standards upon their conduct. Their relationship to the plaintiff class is one of trust; the entire scheme of our investment company and advisor regulation is predicated upon that trust being respected inviolate. A breach of a fiduciary duty traditionally has been considered a much graver transgression than, for example, breach of a contractual duty. ..In cases involving fiduciaries,...the usual rule traditionally have been modified to insure that the trust relationship

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* References are to pages of the Joint Appendix.

** The majority also notes, in support of its decision, that "[w]e may not assume that nonclass member shareholders would approve of the Fund underwriting these expenses for the benefit of other shareholders." (Slip Opinion, p. 4583.) If the matter were put to a vote, however, it is reasonable to assume that a majority of the Fund shareholders would approve of the Fund's bearing these expenses, since approximately 60% of the Fund's shareholders are members of the class (A-145--A-174).

is not abused. The norms appropriate in the context of arms-length bargaining are simply inapposite in the fiduciary context. Thus, the usual rule should not apply to preclude class action when to do so creates a serious potential for insulating fiduciary breaches from redress." (Slip Opinion, pp. 4596-4597.)

B.

The District Court did not Commit Reversible Error in Determining that the Fund should Bear the Costs of Culling out the Names of Class Members from its Computer Tapes, since the Added Expenses were Necessitated by the Defendants' Requests with Regard to the Definition of the Class.

As indicated above, this Court, in Eisen III, specifically stated that courts may find justification, depending upon the particular facts and circumstances involved, for holding that the plaintiff is not obligated to pay the costs of notice.*

In the instant case, consistent with the principles set forth by this Court in Eisen III, the district court determined that, under the particular facts and circumstances of this case, the Fund should bear the cost of culling out from its computer tapes the names of class members. The District Court stated:

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*This Court stated in Eisen III:

"Nor did we decide or intend to say [in Eisen II, 391 F.2d 555 (2d Cir. 1968)] that in all cases or under all circumstances plaintiffs in class actions are or must be required to defray the cost of giving the various notices specified in amended Rule 23....There may be other similar examples of class actions in which, depending on the circumstances of particular cases, courts might find justification for holding that a representative plaintiff was not obligated to defray the cost of giving the notices required by amended Rule 23. We do not attempt any enumeration. * * * " (479 F.2d at 1009, fn. 5.)

> "Moreover, with respect to the cost of culling out the list of class members, I am ruling that this is the responsibility of defendants. Whether this would be the correct allocation in other cases, I do not attempt to say. But here the expense is relatively modest and it is the defendants who are seeking to have the class defined in a manner which appears to require the additional expense." (A-175; emphasis supplied.)

In reversing the district court, the majority, notwithstanding the foregoing express statement by the district court that the added expenses of culling out the names of class members were necessitated by the defendants, appears to have concluded that these expenses were not attributable to "partisan demands" on the part of the defendants but rather to reasons "unrelated to the interests of the defendants" (Slip Opinion, pp. 4586, 4587).* In support of their conclusion, the majority points to the fact that the district court indicated, in its opinion, that the definition of the class proposed by the plaintiffs would involve an arbitrary reduction in the class, and it ruled in favor of the defendants in defining the class. From this the majority argues that the additional identification costs cannot be viewed as expenses necessitated by partisan demands on the part of the defendants, and accordingly it was improper for the district court to impose these costs upon the defendants. What the majority overlooks is that the district court's rulings in this

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* Contrary to the majority, Judge Hays was of the view that the district court had, indeed, found that these additional expenses were "attributable to defendants' objections to plaintiffs' efforts to define a subclass minimizing expenses..." (Slip Opinion, p. 4594).

case with regard to the definition of the class, the method of giving notice and the allocation of the costs of culling out the names of class members from the computer tapes of the Fund were obviously interrelated and reflect the district court's considered judgment as to a fair overall disposition of this matter, taking into account the respective positions and proposals urged by the parties with respect to these matters. Whether the district court would have refused to define the class as proposed by the plaintiffs had it not also determined that the Fund should be responsible for the additional costs involved in defining the class in the manner sought by the defendants is questionable. The majority appears erroneously to assume that it would have been legally improper for the district court to have overruled the defendants' objections and to have defined the class as sought by the plaintiffs. We submit, on the contrary, that the district court could have defined the class as proposed by the plaintiffs consistent with the principles of Rule 23,* but determined instead, in the exercise of its discretion, to grant the defendants' request with regard to the definition of the class and to require defendants to bear the additional expenses involved in defining the class as sought by them.

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* There is substantial authority indicating that the courts should employ the full measure of discretion under Rule 23 to allow classes to be defined by the plaintiffs so as to permit utilization of the class action procedure, Dolgow v. Anderson, 43 F.R.D. 472, 492 (E.D.N.Y. 1968), even where "the restriction on the scope of the class appears arbitrary." State of Illinois v. Harper & Row Publishing, Inc., 301 F. Supp. 484, 494 (N.D. Ill. E.D. 1969). See also Eisen IV, supra, at 179, n. 16, indicating that the class might be redefined by the plaintiff and the scope of the class reduced so as to minimize the costs of notice.

We further submit that, from a fair reading of the entire opinion of the district court, it is evident that the district court took into account the "partisan demands" of the defendants in deciding upon the definition of the class and in determining to require the Fund to bear the additional expenses involved in culling out the names of the class members from its computer tapes.

The majority decision also misconceives the proper role of the district court in giving notice to the class under Rule 23 (c)(2). In seeking to support its determination that the district court could not properly impose the added expenses of identifying class members upon the defendants, the majority concludes that the defendants' concern, with respect to sending the notice to shareholders of the Fund who were not class members (as proposed by plaintiffs), was legitimate, notwithstanding the fact that the Fund shareholders had been advised of the nature and pendency of this suit 13 times since 1970, in proxies, prospectuses and annual reports, because "we think that notice of that type...would have a far milder impact than a separate communication (though mailed with other papers) composed by the plaintiffs, giving a detailed explanation of the claims and without a denial of merit..." (Slip Opinion, pp. 4586-4587; emphasis supplied). In reaching this conclusion, the majority completely ignores the fact that Rule 23(c)(2) provides that the court shall direct notice to the class and that the form and content of this notice is not determined by the plaintiffs but rather by the court. Thus, the district court

could fully protect the legitimate interests of the defendants in passing upon the form of notice in the case. Accordingly, it was premature for the majority to have concluded, as it did, that the defendants' concern that the mailing of the notice to non-class members would have an adverse effect upon the Fund was legitimate. We believe that the majority's approach on this point further evidences a misconception as to the proper role of the district court in connection with certain matters relating to the maintenance of class actions under Rule 23.

The district court determined that, under the particular facts and circumstances of this case, it would be appropriate to have the defendants, and, in particular, the Fund, bear the cost of culling out the names of class members from the computer tapes of the Fund. We submit that the decision of the district court is fully compatible with Rule 23 and with the principles set forth in Eisen III and in Eisen IV and represents a proper exercise of the role of the district court in handling the complicated and varying problems presented by class actions.

POINT II

THE MAJORITY ERRONEOUSLY DETERMINED THAT THE DISCOVERY RULES WERE INAPPLICABLE IN DETERMINING WHETHER THE DISTRICT COURT HAD COMMITTED REVERSIBLE ERROR IN REQUIRING THE FUND TO BEAR THE COST OF CULLING OUT THE NAMES OF CLASS MEMBERS FROM ITS COMPUTER TAPES.

The majority states that the cost of discovering the names of class members does not differ in kind from the cost of printing the notice and of procuring, stuffing and posting the

envelopes, and, thus, the discovery rules are inapplicable in determining whether the district court committed reversible error in imposing the costs of identification upon the defendants in this case (Slip Opinion, pp. 4587, 4588). The majority's analysis of this issue is, we submit, unsound. As Judge Hays correctly observed in his dissenting opinion:

> "When identificaiton is sought information allowing a party to proceed with his suit is at the core of the request. Thus, in purpose and effect such a request is not different in kind from other requests for information routinely made during discovery. That a suit will be unable to proceed absent identification does not vitiate the validity of characterizing identification as a product ascertainable by discovery and governed by the rules applicable thereto. A contrary view clearly is belied by the common practice of establishing jurisdiction by means of discovery." (Slip Opinion, p. 4593.)

Under the majority's decision, if a plaintiff, prior to filing his class action motion, served a request under Rule 34 of the Federal Rules of Civil Procedure to obtain production of computerized information relating to the identification of class members, the district court presumably would be required to impose upon the plaintiff all of the costs involved in securing this information and would have no discretion in the matter. The majority, we believe, establishes an ill-advised precedent, which may produce inequitable results, not only in this case but in future cases. As Judge Hays notes:

> "Since the disclosing party has opted to keep his records on computer tapes, there is good reason to allow the district court the usual discretion as to costs of retrieving information from those tapes lest discovery be obstructed by irretrievably burying information to immunize business activity from later scrutiny." (Slip Opinion, pp. 4593-4594.)

In Eisen IV, the Supreme Court held that the cost of notice is, in the usual case, the responsibility of the plaintiff "as part of the ordinary burden of financing his own suit." Eisen IV, supra, at 179. The allocation of expenses relating to the discovery of information, however, has traditionally rested within the sound discretion of the district court and has not been automatically regarded as part of the ordinary burden of a party of financing his own suit. The majority, however, would distinguish discovery of information relating to the identification of class members from discovery of information generally, presumably because the former relates to class action requirements in the case. Carried to its logical conclusion, the majority's decision may require district courts automatically to impose upon the plaintiff the costs of discovering information bearing upon other matters (in addition to notice) that are germane to the requirements for maintaining the suit as a class action under Rule 23, such as the description of the class, the numerosity of class members, etc. Thus, under the majority's decision, the district courts, in allocating the expenses of discovery, might be required to differentiate between information that is relevant only to the class action requirements of the case and information that is relevant to the merits generally. We submit that no such distinction is either compelled or intended by Rule 23 or by Eisen III or Eisen IV and that such a distinction is both inappropriate and inadvisable. We further submit that matters pertaining to discovery of information, whether they relate to class action matters or to the merits of the case, should be left

to the sound discretion of the district courts and that the district courts' determination with respect to the allocation of discovery expenses relating thereto should be disturbed only upon a showing that there has been an abuse of discretion.

While the majority suggests that, if the discovery rules were applicable, it is unlikely that they would require the defendants to bear the identification costs in the instant case, the majority does not reach the question of whether the district court abused its discretion in requiring the Fund to bear the cost of culling out the names of class members from its computer tapes but rather rests its decision upon the conclusion, which, we submit, is erroneous, that the discovery rules are inapplicable in determining whether the district court committed reversible error in this case. (Slip Opinion, pp. 4587, 4588).*

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* In his dissenting opinion, Judge Hays refers to the well-established practice that the discretionary judgment of a district court in the realm of discovery should not be disturbed absent a showing of abuse and that the discovery of class members should provide no exception. Judge Hays concludes that, based upon the facts and circumstances in this case, the district court did not abuse its discretion in imposing the cost of culling out the names of members of the class upon the Fund, citing, among other authorities, 8 C. Wright and A. Miller Federal Practice and Procedure § 2218 at 659 (1970). (Slip Opinion, pp. 4593-4594.)

CONCLUSION

For the reasons set forth herein, and in the dissenting opinion of Judge Hays, we respectfully request that this Court grant a rehearing of its decision of June 30, 1976; and that, upon rehearing, its decision of June 30, 1976 be vacated and judgment entered affirming the order of the district court in all respects. For the foregoing reasons, we also respectfully suggest that in this case a rehearing in banc is appropriate.

Respectfully submitted,

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Service of 2 copies of this within
Petition is admitted this
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